THE GLOBE AND MAIL

November 5, 2014

Avigilon silences the doubters. Or at least most of them

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This was shaping up to be an *annus horribilis* for Avigilon Corp., the Vancouver-based seller of high-definition surveillance cameras. After zooming into 2014 with an eightfold jump from its 2011 IPO price, the shares stumbled on a string of executive departures and underwhelming results. As recently as Oct. 15, the stock was down more than 60 per cent from its 52-week high.

Not so much, any more. The company shook off its doldrums and thwacked Bay Street expectations for third-quarter sales and profit Tuesday after the markets closed. The shares finished Wednesday up 30 per cent.

So, are all the problems behind it? Perhaps. But it wouldn't be Vox if we didn't run through a number of the red flags flying at the company earlier this year – and question whether they've been truly packed away with this week's results.

For this, as is often the case, we turn to the analysts at ***Veritas Investment Research***, who published a note to clients in late July detailing some concerns. The ***Veritas*** report was less dramatic than some of its other research, as it attached neither a "sell" rating (as the firm often does on stocks it is critical of) nor a price target to the shares.

The report – as well as general investor concern about Avigilon – was prompted by the departure of chief financial officer Bradley Bardua, literally announced on the eve of the company's first-quarter results in May. It was the latest in a string of executive departures, particularly in the company's finance division, and it drove questions about whether there was something amiss about the company's financial reporting.

Taken in isolation, the departure of one or more finance executives isn't evidence of a problem. ***Veritas's*** concerns, instead, were driven by a number of other items.

One is the company's use of three different auditors in the past five years. While the switch from a smaller firm to a "Big Four" accountant is typical of a company that seeks to go public, ***Veritas*** notes, switching from one large firm to another in the year after the initial public offering is not. (Avigilon management, which responded to ***Veritas's*** questions, told the research firm the switch was due to a "deficiency in quality of service.")

As Avigilon changed auditors, it also changed its disclosure on how it recognized revenue. In 2011's financial statements, Avigilon said it recorded sales of its systems upon delivery to the end customer. In 2012, it said it booked sales on shipment of the systems.

Veritas says Avigilon told it the change was "semantics," and was required by the company's auditor. There is no actual change to the policies, the company reiterated on Wednesday.

However, wrote ***Veritas's Michael Yerashotis***, the author of the report: "If applied, this apparent change would have the effect of accelerating the company's revenue recognition. … We simply question why the company’s auditor required the disclosure change and view it as a red flag that management believes there is no substantive difference between recognizing revenue upon shipment vs. delivery and/or customer acceptance.”

Veritas also noted that Avigilon’s auditors had not been performing quarterly reviews of financial statements – something that, while permissible under Canadian securities law, “is unusual for a $1-billion TSX-listed company.” Avigilon has since started undertaking quarterly reviews.

All of this leads to ***Veritas’s*** most controversial suggestion: Avigilon’s strong relationships with its network of security-system integrators increases the risk of “channel stuffing,” where products get shipped and recorded as revenue before it’s clear that an end user is implementing the system.

This sparked an unusual amount of pushback from the sell-side analyst community. CIBC’s Robin Manson-Hing spoke with nine Avigilon integrators and said “there is no channel stuffing … [they] purchase from Avigilon what their customers want and typically do not keep inventory on hand.” BMO’s Thanos Moschopoulos says he asked a number of integrators “whether they stock inventory and the ones that we’ve spoken to have all confirmed that they don’t.” The company is more direct, calling the suggestion “incorrect and baseless,” and pointing out that ***Veritas*** acknowledges “no direct indicators of channel stuffing or premature revenue recognition.”

I myself made a call Thursday – to Mr. Bardua, who, as it turns out, took a new job at a private company called Endurance Wind Power, just a few weeks after Avigilon said he was leaving “in connection with a personal health issue.” He declined to comment, and when I asked him about his health, he said, “I will leave you to speculate on whether there was an issue with my health or not.”

Speculation has been the bane of Avigilon stock for several months now. For many, this week’s results have put an end to it. But I’ll return to ***Veritas’s*** closing comments: “Although we see smoke, we do not see a smoking gun. However, in our experience, ‘accounting bombs’ rarely telegraph a smoking gun and circumstantial red flags are not definitively proven until well after a company’s share price has already collapsed … we recommend investors risk-adjust the price they are willing to pay for the growth story.”